

D.T.E. 00-79-A

Petition of Western Massachusetts Electric Company for approval by the Department of Telecommunications and Energy of a three-year Energy Efficiency Plan covering the period 2000-2002.

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FOR: WESTERN MASSACHUSETTS ELECTRIC
COMPANY
Petitioner

I. INTRODUCTION

On June 30, 2001, the Department of Telecommunications and Energy (“Department”) directed Western Massachusetts Electric (“Company” or “WMECo”) to file an updated energy efficiency budget and specific performance incentive goals for 2002. Western Massachusetts Electric Company, D.T.E. 00-79, at 8 (2001) (“D.T.E. 00-79”). On March 28, 2002, pursuant to D.T.E. 00-79, G.L. c. 25, § 19, G.L. c. 25A, § 11G, and Order Promulgating Final Guidelines to Evaluate and Approve Energy Efficiency Programs, D.T.E. 98-100 (2000) (“D.T.E. Guidelines”), WMECo filed with the Department (“Department”) a 2002 Update (“Update”) to its three-year Energy Efficiency Plan (“Plan”) that covered the period 2000-2002. The Department reviews this Update in the docket in which the Plan was approved, D.T.E. 00-79.

On April 12, 2002, pursuant to G.L. c. 25A, § 11G, 225 C.M.R. § 11.00 and the D.T.E. Guidelines at § 6.2, the Commonwealth of Massachusetts, Division of Energy Resources (“DOER”), filed a report on the Update with the Department (“DOER Report”). The DOER Report concluded that the Update is substantially consistent with the statewide energy efficiency goals required by G.L. c. 25A, § 11G, and with DOER’s Guidelines for energy efficiency programs (DOER Report at 2). See Guidelines Supporting the Massachusetts Division of Energy Resources Energy Efficiency Oversight and Coordination Regulation 225 C.M.R. 11.00.

On June 13, 2002 WMECo filed a revision to the Update (“June 13 Revision”), adding performance goals for energy savings to other performance goals whose achievement

determines the amount of the shareholder incentive. The Company responded to eighteen Department information requests. On September 25, 2002, pursuant to the D.T.E. Guidelines at § 1(2), WMECo filed a motion requesting approval of a performance incentive calculation and rate that differs from the method proposed in the D.T.E. Guidelines at § 5 (“Motion”). On September 30, 2002, DOER filed a letter (“DOER Letter”) with the Department stating that, with the revised shareholder incentive proposal, the Update remains substantially consistent with the statewide energy efficiency goals and DOER’s Guidelines for energy efficiency programs.¹

II. STANDARD OF REVIEW

The Department is required to ensure that energy efficiency activities are delivered in a cost-effective manner utilizing competitive procurement processes to the fullest extent practicable. G.L. c. 25, § 19; G.L. c. 25A, § 11G. The Department has established Guidelines that, among other things, set forth the manner in which the Department would review ratepayer-funded energy efficiency plans in coordination with DOER, pursuant to G.L. c. 25, § 19 and G.L. c. 25A, § 11G. D.T.E. 98-100.

DOER has the authority to oversee and coordinate ratepayer-funded energy efficiency programs, consistent with specified goals, and is required to file annual reports with the Department regarding proposed funding levels for said programs. G.L. c. 25A, § 11G;

¹ On its own motion, the Department moves the Update, the June 13 Revision, the Motion, and WMECo’s 18 responses to Department information requests into the record of this proceeding. The responses are marked as Exhs. DTE-4-1 through DTE-4-15; Exh. DTE 5-1; and Exhs. DTE-6-1 and DTE-6-2. The Department also incorporates by reference into the record of this proceeding the DOER Report and the DOER Letter. 220 C.M.R. § 1.10(3).

225 C.M.R. §§ 11.00 et seq. If the DOER report concludes that ratepayer-funded energy efficiency programs are consistent with state energy efficiency goals, and if no objection to the DOER report is raised, the Department's review of the Plan is limited to cost-effectiveness issues and the use of competitive processes. D.T.E. Guidelines at § 6.2; 225 C.M.R. § 11.2.

III. ENERGY-EFFICIENCY PROGRAMS

A. Summary of Programs

The Update proposes an overall energy efficiency program budget of approximately \$9.4 million in 2002 (Update at 4).² The budget provides for an additional \$700,000 in shareholder incentives based on actual performance compared to the 2002 goals (Update at 9; June 13 Revision). The Plan provides for energy efficiency programs for residential and commercial-industrial ("C/I") customers, in the process seeking, among other things, to transform markets for energy efficiency products and to capture savings during new construction, major renovation, and equipment replacement (Update at 22-30).

B. Cost-Effectiveness

WMECo projects benefit-cost ("B/C") ratios for its 2002 programs that range from 1.26 to 5.05, depending on the program (Update at 21). More specifically, WMECo projects B/C ratios for its year 2002 programs to average 1.53 for ordinary residential customers, 2.45 for low-income customers, and 1.78 for business customers (id.). Overall, WMECo expects the average B/C ratio to be 1.80 (id.).

² The 2000-2002 Plan estimated a budget of \$10 million for 2002. D.T.E. 00-79, at 3.

C. Competitive Procurement

WMECo reports that it out-sources all of its marketing activities, all of its residential program implementation, and 63 percent of its C/I program implementation (Update at 10).³ Similarly, WMECo competitively procures all of its market research and evaluation activities that are out-sourced (id.). However, the Company conducts most program planning and administration in-house (id.).

IV. Shareholder Incentive Level

A. WMECo Motion

A company's shareholder incentive is tied to the rate on three-month Treasury bills ("T-bill rate"). D.T.E. Guidelines at § 5.3. WMECo maintains that very low T-bill rates in the last year, over which the Company has no control, do not "allow for a performance incentive that can motivate the Company in a meaningful way" (Motion at 2). WMECo, pursuant to the D.T.E. Guidelines at § 1(2), proposes that the incentive calculation algorithm be modified for 2002 (Motion at 2; Update at 5). WMECo proposes a target after-tax shareholder incentive for successful program implementation, based on achieving 31 design level performance goals, that is 4.25 percent of its overall budget (Motion at 2; Exh. DTE-5-1). The 4.25 percentage is higher than the average T-bill rate of 1.87 percent over the last 12 months, but lower than the average 6.89 percent incentive that WMECo has earned over the most recent five years

³ In some programs, instead of WMECo outsourcing implementation, participating customers procure energy efficiency services and equipment themselves, generally using competitively procured vendors and subject to all of the elements of an open, competitive market place. D.T.E. 00-79 (2001), at 6, citing Exh. DTE-1-4.

(Motion at 2; Exh. DTE-6-1). WMECo states that, with the proposed incentive levels, its programs are actually slightly more cost-effective than with incentives set at the T-bill rate (Exh. DTE-6-2). WMECo notes that the stakeholders in its Energy Efficiency Programs support the Motion (Motion at 1).⁴

B. DOER Letter

DOER supports the Company's proposal (DOER Letter at 2). DOER concludes that the proposal is adequate to motivate the Company to pursue the highest quality programs for ratepayers, as envisioned by the Legislature (*id.*). DOER believes that the present T-bill rate, which is no longer four to six percent (the rate of return on low-risk investments cited in D.T.E. 98-100), but around 1.7 percent, will not adequately motivate the Company to provide high-quality energy efficiency programs (*id.*). Therefore, DOER recommends that the Department allow WMECo's proposed method to calculate the Company's 2002 shareholder incentive, pursuant to the D.T.E. Guidelines at § 1(2) (*id.*).

V. ANALYSIS AND FINDINGS

A. Cost-Effectiveness

WMECo provided expected B/C ratios for its proposed programs for the year 2002 that average 1.80 and that exceed 1.25 for all programs. An Energy Efficiency Program shall be deemed cost-effective if its benefits are equal to or greater than its costs, as expressed in present value terms. D.T.E. Guidelines at § 3.5. The Department has reviewed the method by which

⁴ These stakeholders include the Northeast Energy Efficiency Council and the Low-Income Energy Affordability Network (Motion at 1).

the Company determined the benefits and costs for the Update and finds that the benefits and costs were determined consistent with Department criteria for establishing program cost-effectiveness. D.T.E. Guidelines at §§ 3-4. Therefore, the Department concludes that the programs listed in the Update are cost-effective.

B. Competitive Procurement

WMECo provided evidence that it out-sources all of its marketing and most of its program implementation (some business participants procure their own efficiency services and equipment), and competitively procures most of its market research and evaluation activities. At the same time, WMECo conducts most program planning and administration internally to ensure effective program oversight. D.T.E. 00-79, at 6. Accordingly, the Department finds that the Update provides for competitive procurement to the fullest extent practicable.

C. WMECo Motion

When an entity seeking Department approval of its Plan requests a different method from that specified in the Guidelines, the burden falls on that entity to demonstrate the compelling nature of such a request. D.T.E. Guidelines at § 1(2). WMECo has requested a different method to calculate its incentive for the 2002 program year. The Department has recognized that the size of an incentive must balance promoting good program management with benefitting ratepayers by directing most of the budget to program implementation. See, Order Promulgating Proposed Guidelines to Evaluate and Approve Energy Efficiency Programs, D.T.E. 98-100, at 37 (1999). DOER, the agency charged by the Legislature with much of the oversight of energy efficiency programs, has agreed that offering an incentive is

needed to motivate companies to manage their energy efficiency programs well. Id. at 35.

DOER maintained that an incentive of four to six percent, equal to a three to four percent risk-free inflation-adjusted rate of return plus an inflation rate of one to two percent, would be sufficient to motivate electric companies to manage energy efficiency programs well. Id. at 36.

DOER stated that the then-recent T-bill rate fell in the required four to six percent range. Id.

In choosing the T-bill rate for the D.T.E. Guidelines, the Department considered DOER's advice that the T-bill rate would approximate the risk-free rate required to motivate electric companies to manage energy efficiency programs well. In this proceeding, the Company and DOER have made it clear that the T-bill rate is now much lower than the rate recommended by DOER in D.T.E. 98-100. While the proposed 4.25 percent target exceeds the rate now implicit in the D.T.E. Guidelines, it is not only lower than the percentage the Company earned in recent years, it is near the low end of the range that DOER three years ago deemed sufficient to induce electric companies to manage programs well. The Department reaffirms that an incentive must be large enough to promote good program management, but small enough to leave almost all of the money to directly serve customers. The Company's proposal balances these two objectives and is consistent with the DOER information that the Department used in writing the D.T.E. Guidelines. Accordingly, the Department grants the Company's request for an exception to the D.T.E. Guidelines for the calendar year 2002.

D. Benefits of Market Transformation Programs

In calculating the benefits of market transformation programs, savings from any energy equipment expected to be installed in the future due to a current program shall be distinguished from savings from such equipment installed to date. D.T.E. Guidelines at §§ 4.2.1(b) and 4.2.2(b). The Department has required companies to measure how accurate projected equipment lifetimes have turned out to be, using observations several years later of actual equipment lifetimes and failure rates. See e.g., Boston Edison Company, D.P.U. 90-335, at 110-111 (1992); see also Western Massachusetts Electric Company, D.P.U. 91-44, at 147-148 (1991); Western Massachusetts Electric Company, D.P.U. 97-8-CC, at 7-8 (1997). Similarly, the Department will require companies, including WMECo, to jointly track actual equipment installations or sales after a market transformation program ends and compare those to their earlier projections of the same. WMECo and other companies may also track and report other measures of market transformation, such as changes in building or equipment efficiency codes, models offered by manufacturers, or emergence of significant new market players.

E. Conclusion

As noted, the DOER Report and DOER Letter concluded that the Update is substantially consistent with DOER's statewide energy efficiency goals. The Department found above that the Company's 2002 Update is cost-effective and provides for competitive procurement to the fullest extent practicable. Accordingly, the Department approves the Company's 2002 Update. Finally, the General Court has mandated that funding for energy efficiency programs continue through 2007. G.L. c. 25, § 19. The Department directs the

Company to file an energy efficiency plan for its future energy efficiency activities on or before March 7, 2003.

VI. ORDER

Accordingly, after due notice, opportunity for public comment, and consideration, it is hereby

ORDERED: That the Petition of Western Massachusetts Electric Company for approval of the Update to its energy efficiency plan is APPROVED; and it is

FURTHER ORDERED: That Western Massachusetts Electric Company follow all other directives contained in this Order.

By Order of the Department,

Paul B. Vasington, Commissioner

James Connelly, Chairman

W. Robert Keating, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

TABLE 1. WMECo Energy Efficiency Budget (\$000) and Planned Benefit/Cost Ratios

	2002	
	Budget	B/C Ratio
Residential		
New Construction (Energy Star Homes)	628	*
Spectrum & Residential Conservation Services	628	1.26
Products and Services		
Smart living Catalog	381	1.89
Retail Lighting	783	2.10-5.05
Energy Star Appliances	274	*
Other	315	
Subtotal Residential	3,009	1.53
Low-income		
In-Home Services (Energy Smart)	914	2.45
Other	107	
Subtotal Low Income	1,021	2.45
Commercial / Industrial		
New Construction	888	2.75
Retrofit Programs		
RFP	817	2.20
Municipal	765	1.29
Small C&I	698	1.54
Products and Services		
Custom Services	1,950	1.28
Express Services	312	3.50
Other	636	
Subtotal Commercial/Industrial	6,066	1.78
TOTAL BUDGET		
	10,096	1.80

Source: Update, Tables 2 and 6

* These programs are being analyzed on a state-wide basis. WMECo has not yet filed these B/C ratios.

“Other” represents expenditures for administration, planning and evaluation, collaborative, DOER research, and data processing.

Expected shareholder incentives are allocated to individual programs.